(5)

No. 85-560

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

JACK R. & MARIA MATTOX,

Petitioners,

v.

UNITED STATES,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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BRIEF OF PETITIONER

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QUESTION PRESENTED

Whether the plain language of Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, T.I.A.S. 10031, exempts from United States taxation the salaries received by United States citizens employed by the Panama Canal Commission; and whether, in determining this question, the Court below should have given any consideration to a diplomatic communication written more than 7 years after the treaty was negotiated for purposes of construing the intent of the signatories to the treaty.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Federal Circuit in Paul H. and Patricia Coplin, et. al., No. 85-504, decided May 10, 1985, rehearing denied July 3, 1985 (Pet. App. 1a-8a) is reported at 761 F.2d 688. The opinion of the United States Claims Court (Pet. App. 9a-69a) is reported at 6 Cl. Ct. 115 (1984).

JURISDICTION OF THE COURT

The judgments of the Court of Appeals for the Federal Circuit were entered May 10, 1985 and petitions for rehearing were denied July 3, 1985 (Pet. App. 70a-71a). The petitions for a writ of certiorari were filed on September 30, 1985 and granted by Order entered January 13, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

TREATY AND STATUTES INVOLVED

The Panama Canal Treaty between the United States of America and Panama, September 7, 1977 T.I.A.S. No. 10030, states, in part:

ARTICLE III

Canal Operating and Management

* * * * *

9. The use of the areas, waters and installations with respect to which the United States of America is granted rights pursuant to this Article, and the rights and legal status of United States Government agencies and employees operating in the Republic of Panama pursuant to this Article, shall be governed by the Agreement in Implementation of this Article, signed this date.

* * * * *

Article XV of the Agreement Between the United States of America and Panama in Implementation of Article III of the Panama Canal Treaty, September 7, 1977, T.I.A.S. No. 10031, governs taxation of the Panama Canal Commission, its contractors and sub-

contractors, and its U.S. citizen employees and their dependents. That Article provides:

ARTICLE XV

Taxation

1. By virtue of this Agreement, the Commission, its contractors and subcontractors are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property.

2. United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, the shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

3. United States citizen employees and dependents shall be exempt from taxes, fees, or other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their sponsor's work with the Commission.

* * *

The Internal Revenue Code of 1954 (26 U.S.C.) provides, in part:

Sec. 894 [as amended by Sec. 205(a), Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, 80 Stat. 1539]. INCOME AFFECTED BY TREATY.

(a) Income Exempt Under Treaty. Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross

income and shall be exempt from taxation under this subtitle.

STATEMENT OF THE CASE

The Panama Canal Treaty between the United States of America and the Republic of Panama was signed September 7, 1977 between the parties and approved by the United States Senate on October 1, 1979. That treaty restored to Panama territorial sovereignty over the Canal Zone, while granting to the United States the right to manage, operate and maintain the canal until the year 2000 under the auspicces of the Panama Canal Commission (Commission), an agency of the United States government (Pet. App. 3a). Article III, paragraph 9, of the treaty provides in pertinent part that "the rights and legal status of United States Government agencies and employees operating in the Republic of Panama pursuant to this Article, shall be governed by the Agreement in Implementation of this Article, signed this date." Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, provides in pertinent part that:

> United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

Petitioner, Jack R. Mattox is a citizen of the United States. Maria R. Mattox, his wife, is a non-resident alien. At all times pertinent to this case, the Mattoxes

were domiciled in the Republic of Panama where Jack Mattox is employed by the Panama Canal Commission as a ship's pilot navigating ocean-going vessels through the canal. For 1980 and 1981, in computing their federal income tax, the wages received from the Commission were included and federal taxes were paid. Thereafter, Petitioners filed claims for refunds with respect to the amount of tax paid from Commission earnings, contending that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty constitutes an express exemption from U.S. taxation on the salary Jack Mattox receives from the Commission.

The Internal Revenue Serrvice denied each claim for refund; and the United States Claims Court ruled in favor of the taxpayers (Pet. App. 9a-69a). On appeal, the United States Court of Appeals for the Federal Circuit reversed the Claims Court decision (Pet. App. 1a-8a).

SUMMARY OF ARGUMENT

Petitioners, Jack R. and Maria Mattox, respectfully submit that the language of the implementing agreement exempting from taxation all wages earned from Commission employment should be given literal effect for it is precise and unambiguous. In the event that one needs to go beyond the words of the agreement, then Petitioners believe the Claims Court's thorough analysis of the treaty negotiations in this case is accurate and supported by the evidence of record. That analysis fully supports the conclusion that, under the circumstances of this treaty, the plain words of that treaty exempt their Commission income from taxation

by the United States government. Accordingly, this case is an exception to the general rule that the worldwide income of United States citizens is subject to taxation by the United States, regardless of residence or source of such income.

In construing the unambiguous language of Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, this Court may seek to review the intention of the parties. In so doing, Petitioner's urge this Court to review the record evidence of the history of treaty negotiations as that record was developed before the Claims Court. Consequently, Petitioner's urge this Court give no regard to the telegram from Panama prepared more than seven years after the treaty negotiations as evidence of treaty interpretation.

The trial court's factual analysis is thorough and the legal conclusions are sound and should have been affirmed by the Court below.

ARGUMENT

The Claims Court Properly Concluded That The Taxpayers' Incomes From The Panama Canal Commission Are Exempt From United States Taxation Under Article XV Of The Agreement In Implementation Of Article III Of The Panama Canal Treaty.

A. Introduction.

There is no disagreement with the major premise of the government throughout these proceedings, that generally, United States taxpayer's world wide incomes are subject to tax regardless of their residence and regardless of the source of income. The disagreement in this case arises from the different interpretations placed upon the specific words in paragraph

2 of Article XV which language specifically provides "United States citizen employees and dependents shall be exempt from *any taxes*, fees, or other charges on income received as a result of their work for the Commission." (emphasis added). Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, T.I.A.S. No. 10031.

The United States insists that, rather than a literal translation of these words, the Court should insert new words into this treaty by placing the word "Panamanian" between "any" and "taxes" so that Commission employees salaries would be exempt only from Panamanian taxes, thereby remaining subject to United States taxes under the general rule stated above.

After reviewing the evidence of record developed in this case and applying it to the accepted standards of judicial treaty interpretation, the Claims Court stated there was "*no evidence whatsoever* as to the interpretation given this language by Panama" (Pet. App. 29a), but, concluded that the U.S. government interpretation mentioned above was inconsistent with the negotiating history which showed a resolve by the Panamanians to change the *status quo* with an opportunity to tax the income derived by canal operations (Pet. App. 31a, 28a-42a). Thus, under these circumstances, it became apparent that the phrase "exempt from any taxes" was "the product of a deliberate compromise" (Pet. App. 42a).

B. The Plain Meaning of the Language Used in Article XV Should Exempt Commission Employees From U.S. Taxes Under the Circumstances.

The government's interpretation of the words "any taxes" goes beyond the plain meaning of these words

and requires an explanation as to why the treaty negotiators were apparently so imprecise. In applying the standard of treaty interpretation enunciated in *Sumitomo Shoji America* v. *Avagliano*, 457 U.S. 176, (1982) and related cases cited in the trial court's opinion, the Claims Court looked beyond the plain meaning of the words used in the treaty itself and analyzed, among other things, the negotiating history, between Panama and the United States and the legislative history during ratification by the United States Senate. The trial court's analysis under the circumstances is sound and should have been affirmed.

1. The negotiating history does not support the position of the United States in this matter.

In order to prevail in their interpretation that the phrase "any taxes" means "any Panamanian taxes" the United States must show that the negotiating parties expressly intended an interpretation other than the plain meaning of the words used. They can not do so.

In *Sumitomo Shoji America* v. *Avagliano*, 457 U.S. 176 (1982) the court accepted an interpretation of words in the Treaty of Friendship, Commerce and Navigation with Japan to which both signatories agreed. Consequently, the Court was reluctant to impose a different interpretation than that which the signatories agreed was their stated intention. In this case, there is no such bilateral agreement as to the meaning of "any taxes." Consequently, the trial court examined the negotiating history and found no support for the government's present day rationalization. To be sure, the trial court noted considerable obstacles to determination of what the parties intended with respect to Article XV (Pet. App. 28a) and found

there was no "contemporaneous evidence" of the meaning either party placed on the language of Article XV that is the subject of controversy (Pet. App. 29a). Even though sketchy, the trial court found "the record presented . . . paints a far more complex picture of what happened at the negotiating table than defendant's argument would suggest." (Pet. App. 29a).

The trial court determined that the United States and Panama held widely divergent views on the subject of taxation of Commission employees (Pet. App. 29a; and see R. 99, 102, 105, 107, 109, 110, 112). Moreover, as of June 30, 1977, the United States and Panama were at odds on the income tax question:

> The third thing, on the income tax question which you raised with us— again, I am afraid we can't give you a final answer today . . .
>
> But in fairness to you, we think we ought to probe it further.
>
> We can't give you answer finally, therefore today. We can only tell you what we have received so far and for that reason, we don't want to end it there, but want to take it where we can come back to you again in the next day or two—probably not until after the weekend—and let you know what further work we have done. (R. 115-116).

Unfortunately, there is no explicit contemporaneous record of the final disposition of this issue. However, given this disagreement there is no basis to conclude that Panama acceded to the U.S. negotiators, and the trial court so held (Pet. App. 34a, 37a, 38a, 40a, 42a).

The Court of Claims findings on this point are clearly articulated and, in part, are reinforced by the legislative history upon which the appellant now relies for its interpretation. When the subject came up in Senate hearings the trial court found "Mr. Hansell strongly resisted the suggestion but promised that 'we will find a way to avoid this'. . ." (R. 225). Accordingly, the United States treaty negotiators were given the opportunity to seek a clarification by declaration or reservation but did not do so. Given this colloquy athe record the trial court concluded "if both sides intended that Article XV exempt employees of the Commission from Panamanian taxes, following Senator Stone's suggestion would have clarified the issue once and for all." (R. 227). For this reason the Court concluded "since the defendant has offered no satisfactory explanation for its failure to follow established practice in this sensitive area, the Court must infer that officials of the Department of State who were familiar with the treaty negotiations (and access to the then classified negotiating transcripts) feared that Panama would refuse to concur in their interpretation of Article XV and for that reason refused to seek consent" (Pet. App. 56a). The affidavits from the Panamanian officials in this record confirm that refusal to concur was very likely; (R. 182-192); and appellant's have provided nothing to rebut this concern expressed at the time of the negotiations.

2. The legislative history is not a valid source of treaty interpretation in this case for the government failed to complete that record as directed.

An important premise of the government's position is that the legislative history during the Senate ratification proceedings shows that the United States

negotiators did not intend to exempt U.S. citizens from U.S. tax. This argument is controverted both by the specific words selected by the negotiators for use in the treaty; and by the record of negotiations prior to the adoption of the words in question. Generally stated, where there are differing views of treaty language between the signatories, the extrinsic interpretive aid of legislative history would be of little value. This truism is undoubtedly self-evident where, as here, the government was directed to clarify the legislative history but failed to do so. Under this circumstance the legislative history is not a valid source of treaty interpretation.

The specific words exempting U.S. citizen employees of the Commission from "any taxes" is not sufficiently ambiguous to require resort to legislative history. At best, when viewed in the context of the negotiating history which is of record, the legislative history further confirms the signatories had differing positions on the meaning and intent of the phrase "any taxes." Accordingly, the extrinsic aid of legislative history should be of little value when the language of the treaty itself is not ambiguous. *Hart* v. *United States*, 585 F.2d 1025, 1028 (Ct. Cl. 1978). Ambiguity, if it exists, comes first from the *post hoc* rationalizations contained in the legislative history. Accordingly, the legislative history from the U.S. Senate ratification process should be viewed sparingly for it tends to create ambiguity not present from the terms used in the treaty by the negotiators. *cf, Weinberger* v. *Rossi*, 456 U.S. 25, 35 (1982); *Quern* v. *Manley*, 436 U.S. 725, 735-736 (1978).

This Court has recognized that ". . .treaties are the subject of careful consideration before they are en-

tered into, and are drawn by persons competent to express their meaning and to choose apt words in which to embody the purposes of the high contracting parties." *Rocca* v. *Thompson*, 223 U.S. 317, 332 (1912).

As events have later confirmed, Senator Stone's suggestion that the meaning of Article XV be clarified by further communication between the parties (Pet. App. 49a) assumes a greater consequence.

The government had an opportunity to clarify or resolve the meaning of Article XV as it was brought to their attention during the ratification process (Pet. App. 48a-49a). For this reason: "The failure of our government to comply with this established practice throughout the treaty ratification process, despite serious questions on the proper construction of Article XV raised by Congress, the press and within the Executive Branch itself, diminishes further the deference that the Court can accord defendant's interpretation of the language in question." (Pet. App. 55a).

Given the substantial shortcoming in the government's failure to obtain the requested clarifications to complete the legislative record, the legislative history in this case is not a credible source of treaty interpretation. It lacks the authentication of a contemporaneous understanding between the signatories which it should have had to be a credible source of treaty interpretation.

C. The Claims Court Analysis Was Thorough, Supported by Substantial Evidence, and Proper Under the Circumstances.

The Claims Court recognized a tenet of judicial construction favoring deference towards the interpretation of treaties given by the Executive Branch, but

concluded deference does not equate to "blind acceptance," (Pet. App. 43a); where the Executive's interpretation is "unreasonable or runs contrary to what the court determines was the intent of the high contracting parties" and properly concluded that "courts interpret treaties for themselves" *id*, citing *Kolovrat* v. *Oregon*, 366 U.S. 187, 194 (1961).

It is anticipated the government will continue to assert its belief that its interpretation is entitled to great weight. Petitioners suggest, however, that the government's assertion does not withstand scrutiny for a number of reasons.

In arguing that its position is entitled to great weight the government principally relies upon *Sumitomo Shoji America* v. *Avagliano*, 457 U.S. 176 (1972). Petitioners respectfully suggest that the facts are distinguished from this case in several material respects. Specifically, in *Sumitomo* the issue was whether a United States subsidiary of a Japanese corporation was a Japanese company and thus exempt from U.S. laws including the prohibitions against discrimination in employment. In that case, both signatory governments agreed the subsidiary was not intended to be exempt from U.S. laws against discrimination. Accordingly, the facts were such that the intent of the signatories was clearly and unequivocally expressed. In this case, however, the specific language adopted by the signatories in the treaty is contradicted by the unilateral interpretation advanced by the United States during the ratification process. Under these circumstances, the trial court examined the evidence and after considering the government's argument decided deference was not required under the circumstances of this case.

In support of this conclusion the Court considered and rejected the plausibility of a drafting error (Pet. App. 44a-47a), the failure to clarify the language before it went into effect (Pet. App. 47a-56a); and additional considerations including the lack of a factual basis supporting a significant degree of administrative deference (Pet. App. 56a-58a).

In presenting the argument of judicial deference to Executive Branch interpretation, the government refers to "a large majority of Courts" which have decided against the taxpayer on this issue. (Brief for the United States at page 8). It is particularly significant to note, however, that these decisions are apparently without benefit of the evidence of the negotiating history made available through the discovery process of the Claims Court proceeding (R. 71-180). Thus, for example, the District Court in *Rego* v. *United States*, 591 F.Supp. 123 (W.D. Tenn. 1984) merely refers to the legislative history of the negotiating process. Similarly, in *Corliss* v. *United States*, 567 F.Supp. 162 (W.D. Ark. 1983) the trial court admitted that "taken on its face, the 'any taxes' language of paragraph 2 may be literally read to grant the broad exemption urged by plaintiffs," *id*, 567 F.Supp. at 164 but, then went directly to the legislative history of the Senate hearings and concluded "surely there is no more authoritative source of the United States' position regarding paragraph 2 of Article XV than the above analysis." *id*, 567 at 166. Indeed the limitation of these records is apparent from that court's opinion that "nothing has been offered or brought into question, however, which even intimates that the understanding of the Panamanians is contrary to that of that analysis provided in part by

the United States negotiating team." *id*, 567 F.Supp. at 166. Given the evidentiary limitations of the records before those courts, Petitioners respectfully submit such decisions are of little moment when compared to the extensive analysis and deliberation of the Claims Court.

The Claims Court had the opportunity to fill the factual void with concrete examples of the "divergent views on the subject of taxation of Commission employees." (Pet. App. 29a) and found that "the dispute centered largely on a fundamental disagreement as to the nature and status of the Panama Canal Commission" (Pet. App. 29a-30a). One such record reference, apparently not before either the Tennesse or Arkansas Federal District Courts, was the view of Ambassador Romulo Escobar Betancourt of Panama at the July 12, 1977 negotiating session in which he articulated the difference between Panama Canal Commision employees and military personnel. He stated:

> We're not talking about income tax to be paid by the military assigned to Panama; we're talking about income tax to be paid by citizens whose wages would be derived from the Panama Canal. In other words, the salaries to be paid by the U.S. nationals don't come from the United States but, rather, they would derive from the operation of the canal. So maybe they could be allowed to pay taxes in Panama since from here on they'll be working under Panamanian jurisdiction and using Panamanian services (Pet. App. 31a).

The distinction, advanced by the Panamanian ne-

gotiators is consistent with an elementary tenet of taxation as enunciated in *Johansson* v. *United States*, 336 F.2d 809 (5th Cir. 1964) recognizing that income from services is taxable where services are rendered. Moreover, the Panamanian negotiating posture at the time was logically sound in contrasting between services of Commission employees and members of the U.S. armed forces. That is to say, services of Commission employees enure to the benefit of the operation of the canal, whereas services of members of the U.S. armed forces enure to the benefit of the United States government.

Given the fundamental distinctions and divergent views of the negotiators on this point the Claims Court analyzed the negotiating process and found that " . . . the positions of the parties hardened and their differences grew wider rather than narrower" (Pet. App. 34a), and further that " . . . the contemporaneous record of negotiations abruptly ceases" (Pet. App. 34a). The government admits that "no official transcript of the negotiations were kept on the 1977 Treaty negotiations" (R. 60-61) and that " . . . in the absence of any reegularized agreed negotiating history for either the treaty or the implementing agreements, the only source is the documents themselves" (R. 61).

Under these circumstances, i.e. no clear expression of the intent of the signatories, the Claims Court analyzed the obligation of the United States to clarify the language prior to ratification (Pet. App. 47a-56a) and concluded, "that the reluctance casts doubt upon the defendant's assertion that the Article XV language was an error rather than compromise" (Pet. App. 47a).

The conclusion of compromise was firmly predicated upon the contemporaneous evidence of the negotiating history; however, it was reinforced by the actions and stated reluctance of the government to obtain a clarification before the trial court. Specifically, the trial court gave the government an opportunity to obtain clarification. "Indeed, after expressing considerable skepticism as to defendant's position, Feb. 23 Transcript at 52, 65-66, the Court recessed for two weeks to give defendant an opportunity to consider supplementing the record by obtaining an indication from Panama as to its intentions in agreeing to the language of Article XV. At the next hearing on the matter, defense counsel informed the court that *no clarification would be requested or obtained from Panama*" (emphasis added) (Pet. App. 64a).

Throughout the Claims Court proceedings the government "steadfastly refused the opportunity to supplement the record" (Pet. App. 64a). Thus, a major premise of the Claims Court opinion was that after considering the explicitly divergent views of record between the Panamanian and United States negotiators on the subject of taxation of Commission employees, and given the lack of evidence of how they resolved their differences, then it follows the language was a compromise (Pet. App. 47a).

It was, therefore, a substantial change in the government's position when on the eve of oral argument before the Federal Circuit in March, 1985, the government tendered a copy of correspondence from the Panamanian Foreign Ministry which was at substantial variance from the record under review on appeal. This late filed material was considered by the Federal Circuit panel as revealing " . . . the intent of each

government" (Pet. App. 7a). The Eleventh Circuit rejected this late filed attempt and rejected "matters not presented to the lower court" (Pet. App. 78a).

Petitioners respectfully submit that the Eleventh Circuit's ruling on this issue is better founded in fundamental fairness, and more consistent with this Court's holding in *Sumitomo Shoji America Inc.* v. *Avagliano*, *supra*, for several reasons.

First, the governments action is more than merely clarifying a record on appeal as countenanced in *Sumitomo Shoji*, *supra*. It is not only a substantial departure from the record position of the government in the proceedings below, but it is a practice, if permitted, which undermines the fundamental protections afforded to litigants of probing the credibility of evidence through cross-examination.

Equally significant, relying on late-filed diplomatic correspondence of this nature to prove intent of the high contracting parties could fracture the foundation of diplomatic negotiations. If, as the Federal Circuit held, correspondence generated approximately seven and one half years after the fact really " . . . reveals the intent of each government," (Pet. App. 7a) then the foundation of international treaty negotiations would be built upon the shifting sands of continually changing administrations within the respective international governments of the high contracting parties. For this reason alone, Petitioner's respectfully submit that the government's action in this case strains the fabric of fundamental fairness and far exceeds the constraints of treaty interpretation set forth in the considered opinions of this Court. e.g. *Kolovrat*, 366 U.S. at 194; *Sumitomo Shoji*, 457 U.S at 184; and *Factor* v. *Laubenheimer*, 290 U.S. 276, 295 (1933).

CONCLUSION

For these reasons, we respectfully urge the opinion of the United States Court of Appeals for the Federal Circuit be reversed.

Respectfully submitted,

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